In the Supreme Court of the United States

OCTOBER TERM, 1964

No. ——

UNITED STATES OF AMERICA, PETITIONER

v.

MIDLAND-ROSS CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit in the above-entitled case.

OPINIONS BELOW

The opinion of the district court (R. 20a–36a)[1] is reported at 214 F. Supp. 631. The opinion of the court of appeals (App. 7–8) is reported at 335 F. 2d 561.

JURISDICTION

The judgment of the court of appeals was entered on July 29, 1964 (App. 8). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

[1] "R." refers to the appendix to the government's brief in the court of appeals; "App." to the appendix to this petition.

748-108—64

QUESTION PRESENTED

Whether the excess of the face amount of a note over the amount of money for which it was issued represents interest, making the portion of the proceeds of the lender's subsequent sale of the note which is attributable to the excess taxable as ordinary income rather than as capital gain.

STATUTES INVOLVED

Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived * * * from interest, * * * or gains or profits and income derived from any source whatever. * * *
>
> * * * * * *
>
> SEC. 117. CAPITAL GAINS AND LOSSES.
>
> (a) *Definitions.*—As used in this chapter—
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> * * * * * *
>
> (4) *Long-term capital gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months * * *.

STATEMENT

At various times during 1952, 1953, and 1954, respondent advanced large sums of money to financial institutions in exchange for notes of those institutions. The notes, 13 in number, were usually in the face amount of $1,000,000 or $2,000,000, and in each case were payable in less than a year's time. The notes did not in terms provide for interest, but the amount advanced in exchange for the notes was determined by dis-

counting the face amount at a rate agreed upon by the parties (usually between 2% and 2.5% on an annual basis). In each instance, respondent sold the note to a bank a few days before its maturity (R. 15a–18a). A typical transaction, as described in the stipulation, was the following (R. 16a, ¶12):

> On January 29, 1952, [respondent] paid $1,955,416.67 to the Commercial Investment Trust Company and received in return therefor a note of the Commercial Investment Trust Company in the face amount of $2,000,000, payable to the bearer on December 15, 1952. Said note was not in registered form and contained no provision for the payment of interest. On December 4, 1952, [respondent] sold said note to the Union Bank of Commerce for a price of $1,998,166.67, resulting in a gain to [respondent] of $42,750.

Respondent's total gain on the sale of the 13 notes was $282,763. It reported the gain on its income tax returns for the three years as capital gain. The Commissioner determined that the excess of the face amount of the notes over the amount of money for which they were issued represented interest. Since the notes were all sold in the same taxable year in which they were acquired, and since the gain was attributable entirely to the maturing of the notes and the discount at which they were issued, he treated the entire gain realized on the sale of the notes as ordinary income in the nature of interest. Respondent paid the resulting deficiencies in income and excess profits taxes and in due course brought this suit for refund. The district court held the gains taxable

only as capital gain (R. 20a–36a) and entered judgment for respondent in the amount of $192,463 plus interest from the date of overpayment (R. 37a). The court of appeals affirmed, in a brief *per curiam* opinion (App. 7–8),

REASONS FOR GRANTING THE WRIT

The basic question in this case—whether original-issue discount must be accounted for as interest—is identical to that in *Dixon* v. *United States*, No. 486, this Term, in which the taxpayer has filed a petition for certiorari based upon the acknowledged conflict between the decision of the Second Circuit in that case and that of the Sixth Circuit in this case. The notes and transactions involved in the two cases are substantially identical, the only difference between the cases being in the basis upon which the deficiencies were determined. In *Dixon*, the taxpayer was required to accrue the interest earned during the year even on notes that were not sold in that year. In this case, all the notes were sold in the year acquired, and the Commissioner determined the deficiency by simply treating the gain on the sale of the notes as ordinary income—in effect, since it made no significant difference, treating the taxpayer as though it were on the cash basis.[2] Even if the difference in the accounting

[2] Had the taxpayer—in fact on the accrual basis—been required to accrue the "interest" earned during its period of holding, the deficiencies would have been slightly greater, but only by an almost infinitesimal amount. The difference in result was too slight to warrant the additional interest computations that would have been required by a strict application of accrual accounting.

theories on which the deficiencies were determined be thought significant, however, that would still not eliminate the conflict. For the decision below would remain in conflict with the following cases, each of which also involved the treatment of the proceeds from a sale or redemption of a note issued at a discount: *Real Estate Investment Trust of America* v. *Commissioner*, 334 F. 2d 986 (C.A. 1); *Rosen* v. *United States*, 288 F. 2d 658 (C.A. 3); *United States* v. *Harrison*, 304 F. 2d 835 (C.A. 5), certiorari denied, 372 U.S. 934;[3] *Pattiz* v. *United States*, 311 F. 2d 947 (Ct. Cls.).

We are simultaneously filing a response acquiescing in the petition for certiorari in the *Dixon* case. For the reasons there stated, the petition in this case should also be granted so that both accounting treatments will be before the Court at the same time. The records in both cases are so simple, and the notes and transactions involved are so identical, that we do not believe that the burden on the Court will be significantly increased by having two cases rather than one before it. Alternatively, if the Court agrees that the difference in accounting treatment does not affect the issue, it may prefer merely to postpone action on this

[3] *Commissioner* v. *Morgan*, 272 F. 2d 936 (C.A. 9), although also expressing disagreement with the Sixth Circuit, involved an accrual-basis taxpayer who, as in *Dixon*, was required to report the original-issue discount ratably as it accrued.

petition until the final disposition of the *Dixon* case.

Respectfully submitted.

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OCTOBER 1964.

APPENDIX

No. 15524

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MIDLAND-ROSS CORPORATION, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

On Appeal from the United States District Court, Northern District of Ohio, Eastern Division

Decided July 29, 1964

Before: WEICK, Chief Judge, CECIL, Circuit Judge, and MCALLISTER, Senior Circuit Judge.

PER CURIAM. This cause is before the Court on appeal from a judgment of the United States District Court for the Northern District of Ohio granting judgment in favor of the appellee, a taxpayer, against the United States, the appellant. The sole question presented on the appeal is whether original discount income received upon the sale of notes prior to their maturity is entitled to be treated as capital gains under Section 117(f) of the Internal Revenue Code of 1939.

Judge Kalbfleisch of the District Court wrote a comprehensive opinion in the case in which he followed the ruling of this Court in *Commissioner of Internal Revenue* v. *Caulkins*, 144 F. 2d 482. While

some courts [1] have taken a contrary view on the issue presented we are of the opinion that the *Caulkins* case, controlling in our circuit, was correctly decided.

The pertinent facts are stated in the opinion of the District Court reported at *Midland-Ross Corp.* v. *United States*, 214 F. Supp. 631. We agree with the opinion of Judge Kalbfleisch and the judgment of the District Court is affirmed.

JUDGMENT

(Filed July 29, 1964)

Appeal from the United States District Court for the Northern District of Ohio.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Ohio, and was argued by counsel.

On consideration whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be and the same is hereby affirmed.

No costs awarded. Rule 23(4).

Approved for entry:

s/ LESTER L. CECIL,
United States Circuit Judge.

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[1] *Dixon* v. *United States*, — F. 2d —, C.A. 2; *Pattiz* v. *United States*, 311 F. 2d 947, Ct. Cl.; *United States* v. *Harrison*, 304 F. 2d. 835, C.A. 5, cert. den., 372 U.S. 934; *Rosen* v. *United States*, 288 F. 2d 658, C.A. 3; *Commissioner* v. *Morgan*, 272 F. 2d 936, C.A. 9.

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